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AUTHORITIES CITED.

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

EPHRAIM LEDERER, COLLECTOR OF INTERNAL REVENUE for the First District of Pennsylvania, petitioner,
v.
ALEXANDER D. STOCKTON, SOLE SURVIVING trustee under the will of Alexander J. Derbyshire, respondent.
} No. 137.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE PETITIONER.

STATEMENT OF THE CASE.

The facts.

This case is here on writ of certiorari to review the judgment of the Circuit Court of Appeals for the Third Circuit, which affirmed the judgment of the District Court for the Eastern District of Pennsylvania, awarding judgment for the plaintiff in the sum set forth in his pleadings.

The petitioner is the sole surviving trustee under the will of Alexander J. Derbyshire. The will of

Alexander J. Derbyshire, after making certain specific bequests, devised and bequeathed the residue of his estate to his executors and trustees in trust to pay three certain annuities, and further provided:

> And in trust further, and my said executors are hereby directed, after the decease of the said Algemine D. Smith, Caroline Derbyshire, and Eliza Ann Henszey, and of the said Alexander J. Derbyshire, jr., before his arrival at the age of twenty-one years, to convey, assign, transfer, set over and pay unto the contributors to the Pennsylvania Hospital, their successors and assigns, for the charitable uses of the said Institution, all the rest, residue and remainder of my estate, real and personal, and of the income, rents, issues, profits, and accumulations thereof which may remain in the hands of my said executors unsold or undisposed of as aforesaid after the decease of the said Algemine D. Smith, Caroline Derbyshire, Eliza Ann Henszey and Alexander J. Derbyshire, jr., as aforesaid, and after paying and discharging all my debts and funeral expenses, and all the annuities, legacies, bequests, and sums of money hereinbefore and hereinafter devised and bequeathed or directed to be paid, and after paying for and discharging all the charges, taxes, repairs and insurance upon all my estate and property, real and personal, and all the charges and expenses incident to the sale, management, and settlement of my estate and property as aforesaid and as hereinafter mentioned. (R. 9–10.)

Two of the annuitants named by the testator are dead and Alexander J. Derbyshire, jr., is more than twenty-one years of age. The third annuitant is still living, the amount of her annuity being $800 per annum. The income from the trust estate increases somewhat each year, but for the year 1918 it was about $85,000 (R. 24).

The "Contributors to the Pennsylvania Hospital" is a charitable corporation, no part of the income of which is for the benefit of any private stockholder or individual. The will of Alexander J. Derbyshire came before the Supreme Court of Pennsylvania in *Biddle's Appeal* (99 Pa. 525). The court was asked to set aside a sum sufficient to secure the payment of the annuities, which then amounted to $4,400 per annum, and thereupon to authorize payment of the balance of the trust fund to the Pennsylvania Hospital. The court held that the trust created by the testator was active during the life of the annuitants; that the testator intended payment to be made to the hospital only after the death of all the annuitants; and that no portion of the trust fund could then be paid over to the hospital. This decision was reaffirmed in *Derbyshire's Estate* (239 Pa. 389), although at that time the only surviving annuitant had agreed to release her annuity for $25,000, to be paid her by the hospital.

The petitioner as collector of internal revenue assessed against the respondent as trustee a tax upon the income of the trust estate as follows (R. 5, 12):

For the year 1913	$666.58
For the year 1914	896.42

For the year 1915	$992.23
For the year 1916	1,718.19
For the year 1917	6,824.02

The taxes for the years 1913, 1914, and 1915 were assessed under the income tax act of October 3, 1913 (38 Stat. 166), and those for the years 1916 and 1917 under the income tax act of September 8, 1916 (39 Stat. 756), as amended by the act of October 3, 1917 (40 Stat. 300). Respondent on July 3, 1917, paid under protest the taxes demanded for the years 1913 to 1916, inclusive, and on June 11, 1918, paid under protest the tax for the year 1917. Claims for refund of these taxes were filed with the Commissioner of Internal Revenue and were rejected by him (R. 16, 23). The present litigation was then instituted. Both the District Court and the Circuit Court of Appeals held that the respondent was entitled to recover the amounts paid with interest from the dates of payment.

Smietanka v. *First Trust and Savings Bank*, decided by this court February 27, 1922, held that the income tax act of 1913 did not require fiduciaries to pay a tax upon the income of trust estates except in so far as they were required by Paragraph E to pay the normal tax imposed by the act on the income of individuals. Since the act of 1913 did not impose any tax upon the income of a trust estate accumulated for ultimate payment to a corporation, whether that corporation was a charity or not, the petitioner concedes that the taxes imposed upon the respondent for the years 1913, 1914, and 1915 were improperly

assessed and can be recovered in this suit. This case therefore concerns only the taxes for the years 1916 and 1917 levied under the income tax act of 1916.

Applicable provisions of the statutes involved.

Section 2(b) of the act of September 8, 1916, provides:

> Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: *Provided*, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Section 11(a) of this act provides:

> That there shall not be taxed under this title any income received by any * * * corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net

income of which inures to the benefit of any private stockholder or individual.

The act of October 3, 1917, left the above quoted provisions in full force and effect.

The question involved.

The sole question at issue is whether the tax imposed by the income tax act of 1916 upon income held by a trustee for future distribution under the terms of the trust applies to trust income held by a trustee for future distribution to a charity.

ARGUMENT.

I.

The provision in section 11 (a) of the act of September 8, 1916, exempting from tax "income received" by a charity does not apply to trust income which the trustee is required to add to the principal of a fund which is to go ultimately to a charity.

Apart from the fact that the trust fund is to go ultimately to a charity, there is no question that the respondent was properly taxed upon the income of the trust estate under the income tax act of 1916. That act taxes the "income of estates or any kind of property held in trust, including * * * income held for future distribution under the terms of the will or trust." The contention of respondent is that the income in the present case comes within the provision of section 11 (a) of that act, exempting from tax "income received" by a charity.

The present is the ordinary case of trust property coming into the hands of a trustee to be retained

and administered by the trustee according to the terms of the trust. The trustee in the present case has the legal title to the income of the trust, together with the power and duty of investing and reinvesting that income. The trust, as interpreted by the highest court of Pennsylvania, is an active one which can not be terminated, even with the consent of all the parties in interest. The Pennsylvania Hospital does not have legal title to the trust income or any right to its immediate possession, nor any control over its administration or management. The income of the trust is therefore not "received" by the Hospital, whether this word as used in Section 11 (*a*) is interpreted as covering income to which a charity obtains legal title, or income to which it obtains the right of immediate possession, or income as to which it enjoys some right of control or management.

The fact that the trustee loans the balance of the trust income, after payment of the outstanding annuity, to the Pennsylvania Hospital under a blanket mortgage and bond given by the hospital, the hospital paying 4.4 per cent interest on advances thus made, does not alter the situation. (R. 24–25). The moneys thus received by the hospital are received by it, not as income, but as money borrowed, for which it is legally indebted to the trustee and which it may be required to repay to him. Certainly the trustee and the hospital can not enter into any voluntary arrangement which will exempt from tax income otherwise taxable.

In order to recover in the present case, the respondent must establish the proposition that, although income is received and held by a third party, it is nevertheless "received" by a charity under section 11 (a) of the income tax act of 1916 if it will at some future time be paid over to a charity.

The act of September 8, 1916, imposes several different classes of taxes and these are headed by different titles. Title I is headed "Income tax." This title is subdivided into: Part I, "On individuals", Part II, "On corporations"; Part III, "General administrative provisions."

Part I includes sections 1 to 9, inclusive; Part II includes sections 10 to 14, inclusive. Section 1 levies a "normal tax" and an "additional tax" upon the income of individuals. Section 2 (b) provides that the income of trust estates "shall be subject to the normal and additional tax." Section 10 levies a normal tax upon the "total net income received" by domestic corporations and a like tax upon the "total net income received" from all sources within the United States by foreign corporations. Section 11 (a) provides that "income received" by charitable corporations shall not be taxed.

The fact that section 11 (a) is included in a part of the law dealing exclusively with the tax on corporations and that it immediately follows section 10, which levies the tax on corporations, indicates that the exemption accorded by section 11 (a) was intended to apply solely to the taxes imposed by section 10. If this view be correct, section 11 (a) has no

application to taxes imposed, as in the present case, under section 2 (b) in a part of the law dealing with the tax on individuals. But even if this construction is not accepted, the tax exemption given in section 11 (a) with reference to "income received" can scarcely be broader in meaning or have any different scope than the tax imposed upon "income received" in section 10.

In considering what constituted income "received" under the income tax act of 1913 this court rejected the view that an insurance company should return as a part of its income the full amount of the policies written during the year, whether actually collected or not, and held that only the premiums "actually received by it during the year" should be included in its return (*Maryland Casualty Company* v. *United States*, 251 U. S. 342, 346).

This decision as to what constitutes income "received" by a corporation is fully applicable to the income tax act of 1916, which even more explicitly than the income tax act of 1913 taxes the income "received" by a corporation within the taxable year. Since, therefore, the mere possibility, probability or certainty of future payments is not "income received" upon which an income tax is imposed, the exemption from tax of "income received" by a charitable corporation can not extend to income received by a third person as to which there is a possibility, probability, or even certainty that it will be paid to a charitable corporation at some future date.

The fact that the income tax act of 1916 did not make any exemption in favor of income accumulated in a trust fund to go ultimately to a charity is entirely consistent with the basis upon which Congress in that act provided for the taxation of trust income. Congress there clearly expressed its intention of taxing the income of trust estates without regard for the character or interest of the ultimate beneficiaries of the estate. The tax was upon the income of the estate as such. Section 2 (b) of the act of September 8, 1916, reads, "Income received by estates * * * shall be subject to the normal and additional tax and taxed to their estates." The proviso to section 2 (b) reads, "Where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed." This proviso emphasizes that, where income is *not* to be distributed annually or regularly, the tax is to be computed without regard for the character or the interest of the ultimate beneficiaries. It is therefore entirely consistent with the purpose of Congress in taxing the undistributed income of trust estates as an entity for Congress to disregard the fact that the ultimate beneficiary of the estate may be a charity which would have been entitled to an exemption from tax if the income of the estate had been immediately distributed to it.

The provisions of section 219(b) of the income tax act of 1918 which authorized income permanently se

aside for a charity to be deducted in computing the income of trust estates, raise no inference that Congress intended to permit a like deduction to be made in computing the income of trust estates under the income tax act of 1916. Neither the income tax act of 1916 nor the income tax act of 1913 permitted individuals to deduct gifts to charities in computing their net incomes. The income tax act of 1918 changed the law in this respect and paragraph 11 of section 214(a) of that act (40 Stat. 1068) authorized individuals in computing their net incomes to deduct such gifts up to 15 per cent of their total net incomes. The act of 1918 also provided that in computing the income of trust estates a deduction might be made of income which was permanently set aside for a charity, and the act expressly stated that this deduction was "in lieu of" the deduction which individuals might make of their gifts to charities. Subdivision (a) of section 219 of this act imposed upon the income of trust estates and income held for future distribution under the terms of the will or trust the same taxes which the act imposed upon the income of individuals, and subdivision (b) of section 219 (40 Stat. 1071) provided:

> The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) any part of the gross income which, pursuant

> to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for * * * any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; * * *.

The income tax act of 1918 adopted a new policy of making gifts to charities a deductible item from taxable income. Section 219(b) of this act, which authorized income permanently set aside for a charity to be deducted in computing the taxable income of trust estates, was a part of this new policy. This provision indicates, not that Congress intended to permit such a deduction to be made under the income tax act of 1916, but that it intended that under the act of 1916 no such deduction might be made.

The policy pursued in the income tax act of 1916 of not taxing the income received by a charity, but taxing income which, while not received by a charity, might be received by it at some future time, accords with the taxation policy generally followed by State legislatures. While they exempt from tax property in the service of a charity they do not extend the exemption to property owned but not occupied by a charity which the charity intends to use at some indefinite future time for the purpose of its charitable work. (37 Cyc. 928, n. 6; *Boston*

Society, etc., v. *Boston*, 129 Mass. 178; *Presbyterian Board* v. *Fisher*, 68 N. J. L. 143.)

Even if it be assumed that Congress in the income tax act of 1916 had a general intention to exempt all income which might ultimately go to a charity, the court can not give effect to this intention if there are no words in the statute which can be construed as granting an exemption in a case which falls expressly within the taxing provisions of the statute. In *Smietanka* v. *First Trust and Savings Bank*, decided by this court February 27, 1922, the court said:

> It may be that Congress had a general intention to tax all incomes whether for the benefit of persons living or unborn, but a general intention of this kind must be carried into language which can be reasonably construed to effect it. Otherwise the intention can not be enforced by the courts.

The converse of this proposition is that where the tax law covers a certain kind of income or property a general intention on the part of Congress to exempt it from tax will not, apart from express words giving effect to this intention, free it from the tax burden. The courts, indeed, have gone further than this and have said that any doubt as to the existence or extent of an exemption from taxation is to be construed in favor of the Government. In *Cornell* v. *Coyne*, 192 U. S. 418, where exemption from an excise tax was claimed, the court said (p. 431):

> But if there were a doubt as to the meaning of the statute that doubt should be resolved

> in favor of the Government. Whoever claims a privilege from the Government should point to a statute which clearly indicates the purpose to grant the privilege.

Swan & Finch Co., v. *United States*, 190 U. S. 143, 146, is to the same effect.

The Government therefore requests this court to reverse the judgment of the Circuit Court of Appeals for the Third Circuit, which affirmed the judgment of the District Court for the Eastern District of Pennsylvania in favor of the respondent, and to direct the District Court to modify its previous judgment by entering judgment for the petitioner for the amount of taxes paid by the respondent for the years 1916 and 1917.

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APRIL, 1922.

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